

[2011] 198 Taxman 115 (MAG)**TAX DEDUCTIONS****DEDUCTION UNDER SECTION 80HHC WITH RESPECT TO DEPB-INTERPRETATION AND CONTROVERSY REGARDING SECTION 28(iiid) AND THIRD PROVISO TO SECTION 80HHC(3)****DR. RAJ K. AGARWAL* DR. RAKESH GUPTA****

Recently, reversing the decision of the Special Bench of the ITAT in the case of *Topman Exports v. ITO* [2010] 124 ITD 1 (Mum.), the Bombay High Court in the case of *CIT v. Kalpataru Colours & Chemicals* [2010] [192 Taxman 435](#) denied the deduction under section 80HHC regarding consideration on transfer of DEPB giving rise to a controversy regarding allowability of deduction under section 80HHC with respect to consideration on transfer of export incentive in the nature of DEPB, i.e., Duty Entitlement Pass Book Scheme being the Duty Remission Scheme. In this lengthy write-up, the authors have taken up for discussion the same controversy. For the purpose, to analyze the controversy in correct perspective, first of all, they have examined the nature and scheme of deduction under section 80HHC, particularly with reference to the nature and interpretation of third proviso to section 80HHC(3) and then proceeded to interpret language of section 28(iiid), in the light of relevant case law. According to them, it seems that the Special Bench of the ITAT delivered the judgment interpreting the meaning of language of section 28(iiid) as premium on transfer of DEPB with the conviction in its mind in the background that as per the legislative intent of section 80HHC, deduction under section 80HHC cannot be denied with respect to the face value of DEPB to an exporter. They opine that there is a need to apply the principle of harmonized construction of statute so as to resolve the controversy.

Introduction

1. A controversy has arisen regarding allowability of deduction under section 80HHC with respect to consideration on transfer of export incentive in the nature of DEPB, i.e., Duty Entitlement Pass Book Scheme being the Duty Remission Scheme. This controversy has arisen as a result of judgment of the Bombay High Court in the case of *CIT v. Kalpataru*

Colours & Chemicals [2010] [192 Taxman 435](#) denying the deduction under section 80HHC regarding consideration on transfer of DEPB in certain circumstances and reversing the decision of the Special Bench of the ITAT in the case of *Topman Exports v. ITO* [2010] 124 ITD 1 (Mum.).

Nature of Controversy

2. In the case of *Topman Exports (supra)*, the Mumbai Special Bench of ITAT examined as to whether the entire amount received on the sale of DEPB Entitlement represents profit chargeable under section 28(iiid) of the Income-tax Act or whether the profit referred to therein requires any artificial cost to be interpolated. The Tribunal came to the conclusion that—

- (i) The entire amount that is received on the sale of DEPB entitlement does not represent a profit chargeable under section 28(iiid) and the face value of DEPB entitlement is liable to be deducted from the sale proceeds.
- (ii) The face value of DEPB entitlement was chargeable to tax under section 28(iib) while the difference between the sale consideration and the face value of DEPB entitlement would fall for classification under section 28(iid).

In the case of *Kalpataru Colours & Chemicals (supra)*, the Bombay High Court examined this aspect in the appeal filed by the revenue against the above judgment of Special Bench of the ITAT. The Bombay High Court reversing the above decision of Special Bench of the ITAT held that—

- (i) Amount equivalent to the face value of DEPB as well as the amount received in excess of DEPB credit constitute profits of business under section 28(iid). No part of the credit that is available under the DEPB Scheme can fall for classification under clause (iib) of section 28.
- (ii) In the assessment year in question, the assessee had an export turnover exceeding Rs. 10 crores and did not fulfil the conditions set out in third proviso to section 80HHC(3)(c) and, therefore, the assessee was not entitled to a deduction under section 80HHC on the amount received on transfer of DEPB. The contention that the profits on transfer of DEPB in section 28(iid) would not include the face value of the DEPB so that the assessee gets a deduction under section 80HHC on the face value of the DEPB had no merit.

Actual nature of controversy

3. The issue which has been debated and decided in both the above judgments is as to whether under section 28(iid), 'profit on transfer of

DEPB' refers to premium on sale of DEPB or it refers to gross value realized on the transfer of DEPB, i.e., face value and premium both. This debate has got relevance in the context of deduction under section 80HHC, since under third proviso to section 80HHC(3), the sum referred is the sum as mentioned in section 28(iid) and it is the same sum which has been referred and excluded from the 'profits of the business' as per definition of 'profits of the business' given under clause (baa) to Explanation of section 80HHC. Moreover, in the cases of *Topman Exports (supra)* and *Kalpataru*

Colours & Chemicals (supra) question framed and referred for adjudication to the Special Bench of the ITAT was as to ‘whether the entire amount received on sale of DEPB entitlements represents profit chargeable under section 28(iiid) of the Income-tax Act or the profit referred to therein requires any artificial cost to be interpolated?’.

In fact, actual controversy is not as to the meaning and interpretation of the language of section 28(iiid) but the real controversy and question is as to whether deduction under section 80HHC can be denied with reference to the face value of DEPB entitlement and further with reference to the premium on the transfer of the DEPB entitlement. This question assumes significance when the export turnover of the assessee is more than Rs. 10 crores and the assessee is not complying with the two conditions given under third proviso to section 80HHC(3) and does not fall within its ambit.

To address the above question and to analyze the controversy in correct perspective, first of all, one has to understand the nature and scheme of deduction under section 80HHC, particularly with reference to the nature and interpretation of third proviso to section 80HHC(3).

Scheme of deduction under section 80HHC

4. Deduction under section 80HHC is given on the profits derived from the export as per sub-section (1). Further, sub-section (3) has explained the phrase ‘profits derived from the export’ to mean the amount which bears to the profits of the business in the same proportion as the export turnover to the total turnover of the business carried out by the assessee.

‘Profits of the business’ has been defined under clause (baa) of Explanation to section 80HHC to mean the profits of the business as computed under the head ‘Profits and gains of the Business and Profession’ as reduced, *inter alia*, by 90 per cent of—

- (i) Any sum referred to in clauses (iia), (iib), (iic), (iid) and (iie) of section 28, or,
- (ii) Any receipts by way of brokerage, commission, interest, rent, charges or any other receipt of a similar nature included in such profits.

Sums referred to in clauses (iia), (iib), (iic), (iid) and (iie) of section 28 are in the nature of ‘export incentives’ and the other receipts are in the nature of ‘independent incomes’ and in further discussion, these sums have been collectively termed as ‘export incentives’ and ‘independent income’ in the same manner as has been used by the Bombay High Court in the case of *Kalpataru Colours & Chemicals (supra)*.

The scheme of section 80HHC for computing profits derived from exports is thus first to exclude ‘independent incomes’ and ‘export incentives’ from the ‘profits of business’ but since the Legislature intended to give deduction under section 80HHC in respect to the ‘export incentives’, it has included the same back by providing for the deduction by way of four provisos appended to sub-section (3) of section 80HHC.

First, second and third provisos are reproduced hereunder so as to understand the issue properly:—

Provided that the profits computed under clause (a) or clause (b) or clause (c) of this sub-section shall be further increased by the amount which bears to ninety per cent of any sum referred to in clause (iia) (not being profits on sale of a license acquired from any other person), and clauses (iib) and (iic) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee :

Provided further that in the case of an assessee having export turnover not exceeding rupees ten crores during the previous year, the profits computed under clause (a) or clause (b) or clause (c) of this sub-section or after giving effect to the first proviso, as the case may be, shall be further increased by the amount which bears to ninety per cent of any sum referred to in clause (iid) or clause (iie), as the case may be, of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee :

Provided also that in the case of an assessee having export turnover exceeding rupees ten crores during the previous year, the profits computed under clause (a) or clause (b) or clause (c) of this sub-section or after giving effect to the first proviso, as the case may be, shall be further increased by the amount which bears to ninety per cent of any sum referred to in clause (iid) of section 28, the same proportion as the export turnover bears to the total turnover of the business carried on by the assessee, if the assessee has necessary and sufficient evidence to prove that,—

- (a) He had an option to choose either the duty drawback or the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme; and
- (b) The rate of drawback credit attributable to the customs duty was higher than the rate of credit allowable under the Duty Entitlement Pass Book Scheme, being the Duty Remission Scheme."

Fourth proviso is the same as third proviso with the only distinction that third proviso is in respect of DEPB Scheme while fourth proviso is in respect of DFRC Scheme of the Central Government as per the export-import policy.

The whole scheme of deduction under section 80HHC may further be explained and understood by way of an example as under—

Scheme of deduction under section 80HHC

Profit & Loss Account			
Particulars	Amount in Rs.	Particulars	Amount in Rs.
Operating and other business expenses	890.00	Export turnover	500.00
		Domestic turnover	500.00

Expenses relating to independent income	5.00	Commission/interest/rent/ brokerage being independent income	50.00
Expenses relating to export incentives	10.00	Export incentives e.g., DEPB/CCS/Drawback	100.00
Profits	245.00		
Total	1150.00	Total	1150.00

Income under the head 'Business or profession' 245.00

Less : Income from business as per clause (baa) of Explanation to section 80HHC

(i) To exclude 90% of 50	45	
(ii) To exclude 90% of 100	90	135.00
		<hr/>
		110.00
		<hr/>
Deduction u/s 80HHC(3)	$110 \times 500 / 1000$	55.00
Export incentives as per provisos	$90 \times 500 / 1000$	45.00
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Total deduction u/s 80HHC		100.00
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Incidentally, while one can discuss the scheme of deduction under section 80HHC, two questions may creep into mind after going through the above example which may be discussed, though the same may not have bearing on the present controversy but may be significant to understand the scheme of deduction under section 80HHC in the right perspective.

4.1 SOME ISSUES

- (i) Why 90 per cent of export incentive/independent income is reduced to arrive at the 'profits of the business' as per clause (baa) of Explanation to section 80HHC?

In the course of earning income/receipt in the nature of export incentive/independent income, there are certain incidental expenses which may have to be incurred and are debited to profit and loss account. These expenses may be in the nature of administrative expenses incurred directly or indirectly but are debited to profit and loss account and a part of overall business expenses. Under clause (baa), the exclusion from the business profits is to be made for the sum of profits and not gross amount relating to export incentive/independent income. It has been presumed by the Legislature that on a standard basis, 10 per cent of the gross amount of such incomes are the expenses incurred in the business and, therefore, it appears to have been provided under clause (baa) to exclude 90 per cent of the gross amount of export incentive/independent income from the business profits so as to arrive at the 'profits of the business', 'derived from exports'.

- (ii) What is the rationale of first excluding 'export incentives' from the 'profits of the business' and then loading it back for calculating deduction under section 80HHC by way of provisos?

Rationale of first excluding 'export incentives' from the 'profits of the business' and then loading it back for calculating deduction under section 80HHC by way of provisos appears to be attributed to the concept that 'export incentives' may not strictly be construed as 'profits of the business' as the effective source of these incentives are the Government schemes but since export incentives are received from the Government in the course of export, the Legislature intended to give deduction under section 80HHC in respect of 'export incentives'. Therefore, provisos appear to have been added to sub-section (3), providing for deduction under section 80HHC for export incentives.

Principles of deduction under section 80HHC

5. From the above discussion, it is evident that the underlined principles for granting deduction under section 80HHC are that—

- (a) 'Independent incomes' would not qualify for deduction under section 80HHC at all.
- (b) 'Export incentives' are eligible for deduction under section 80HHC.
- (c) In case income/receipt is in the nature of 'turnover', it would be included in the export turnover/total turnover as per its nature in applying the formula for calculating deduction as given in sub-section (3).

Whenever there is any controversy regarding deduction under section 80HHC to be available or not with respect to some income/receipt, the controversy can be resolved by deciding first the nature of income/ receipt - *i.e.*, whether the income/receipt is in the nature of 'independent income' or 'export incentive' or 'turnover' - and then decision may be taken in accordance with the principles as enumerated above.

In the present case, controversy is with respect to the nature of receipt on transfer of DEPB. DEPB sale consideration may have two components, *i.e.*, face value of DEPB and premium on transfer of DEPB. One needs to examine as to whether both the above components are in the nature of 'export incentive' or in the nature of 'independent income'.

Face value of DEPB in the nature of 'export incentive'

6. As per export and import policy, the Central Government grants various kinds of export incentives. Export incentives which have been envisaged under section 28 of the Income-tax Act are import license covered by clause (iiia), cash assistance covered by clause (iiib), duty drawback covered by clause (iiic), DEPB covered by clause (iiid) and DFRC covered by clause (iiie) of section 28.

Import license and cash compensatory scheme and duty drawback were available as per import-export policy prior to 1998 and after that as per new policy, the scheme of DEPB and DFRC were introduced. As per the present policy depending upon the nature of item exported, an exporter may be entitled to get—

- (a) Duty drawback, or
- (b) DEPB/DFRC, or
- (c) An option to choose Duty Drawback or DEPB/DFRC.

The point to be appreciated here is that all the above export incentives are granted by the Government to promote export and to compensate to the exporters for duty paid on input costs incurred. The above schemes are by and large at par in nature and are granted in certain cases, in substitution to each other. Value of the benefit granted by the Government under the scheme is undoubtedly in the nature of export incentive. In the case of CCS or duty drawback, the amount of benefit is received by the exporter as per its face value and these instruments are not marketable. However, in the case of import license/DEPB/DFRC, in case exporter does not want to utilize the benefit for its own purpose, these instruments can be transferred in the open market to the other persons. In the case of transfer of such instruments/DEPB in the open market, it may result in loss/premium. However, face value of DEPB is in the nature of export incentive which is intended to be given by the Government as export incentive.

There cannot be any doubt regarding the nature of face value of DEPB and it is certainly in the nature of export incentive granted by the Government to the exporter.

When the nature of face value of DEPB is in the nature of export incentive, as per discussion held above regarding the scheme and intent of deduction under section 80HHC, deduction has to be available to the extent of face value of DEPB to the exporter under section 80HHC.

Premium on transfer of DEPB - Whether in the nature of 'export incentive' or in the nature of 'independent income'?

7. It may be interesting to examine as to whether premium on transfer of DEPB would be in the nature of export incentive or in the nature of independent income. Generally speaking, the nature of premium on transfer of DEPB is in the nature of independent income. Premium received on transfer of DEPB is not the benefit intended to be given by the Government as export incentive. It is received as a result of independent domestic transaction of transfer of DEPB to somebody else in the open market in case the exporter is not utilizing DEPB benefit for its own purpose. The transaction of sale of DEPB has nothing to do with the activity of export. In case of DEPB, export incentive is to the extent of the face value of DEPB, which is granted by the Government as a result of making export by the exporter. Any premium over and above face value received as a result of transfer of DEPB cannot be said to be in the nature of export incentive and it would classify under the category of 'Independent income'.

However, there may be a situation when premium on transfer of DEPB may be treated in the nature of export incentive and in such a situation it may be eligible for deduction under section 80HHC. Third proviso to section 80HHC(3) has, in fact, envisaged such a situation and has provided for deduction under section 80HHC even for such premium fetched by the exporter.

One can discuss this aspect in detail a little later while discussing object and intent of third proviso to section 80HHC(3). Prior to that, one can dwell upon the legislative intent to allow deduction under section 80HHC with respect to face value of DEPB from another perspective.

Nature and impact of provisos of section 80HHC(3) with respect to deduction under section 80HHC in various situations

8. Deduction under section 80HHC has been granted by the Legislature also by way of four provisos incorporated under section 80HHC(3). As per these provisos, six kind of different situations may result in case of receipt of duty drawback/DEPB by the exporter, which are described as under—

- (i) Exporter gets duty drawback.
- (ii) Exporter gets DEPB and DEPB is utilized for self-use by the exporter.
- (iii) Export turnover is less than Rs. 10 crores and DEPB is transferred by the exporter in the open market.

- (iv) Export turnover is more than Rs. 10 crores and the exporter complies with two conditions given under third proviso, *i.e.*, he has an option to choose either duty drawback or DEPB and while choosing the option of DEPB, rate of duty drawback is higher than DEPB.
- (v) Export turnover is more than Rs. 10 crores and the exporter has no option to choose either duty drawback or DEPB.
- (vi) Export turnover is more than Rs. 10 crores and exporter has option to choose either duty drawback or DEPB and while choosing the option of DEPB, rate of DEPB is higher than duty drawback.

The situation mentioned at point (i) above is straightway covered by section 28(iii) and by first proviso to section 80HHC(3). In such a situation, exporter is entitled to full deduction of the benefit under section 80HHC.

In the case of situation mentioned at point (ii) above, when DEPB benefit is self-used by the exporter, in such situation also, he is entitled to full deduction under section 80HHC. In such a case, by self-use of DEPB benefit, the input cost of the exporter is reduced and the DEPB benefit becomes part of normal business profits entitled to deduction under section 80HHC. This situation can further be explained by way of an example given as under—

DEPB self-used to reduce input cost of purchase

Particulars	Amount in Rs.	Particulars	Amount in Rs.
Opening Stock Add : Purchase (1800-DEPB Rs. 100)	1700.00	Sales	2,000.00
Profit	300.00		
Total	2000.00	Total	2000.00
Profits of Business as per Cl. (baa) = 300.00		(DEPB becomes part of profits of business and eligible for deduction u/s 80HHC)	

In case DEPB is transferred in open market and excluded from the profits of the business, situation would be illustrated by following example :—

DEPB transferred in open market—Receipts credited to P&L a/c

Particulars	Amount in Rs.	Particulars	Amount in Rs.
Opening stock Add : Purchase	1800.00	Sales	2,000.00
Profit	300.00	Receipt of DEPB	100.00
Total :	2100.00	Total:	2100.00
Profits of business as per Cl. (baa)		= 300-90% of 100	
		= 300-90=210	

The situation mentioned at point (iii) above is straightway covered by section 28(iii) and second proviso to section 80HHC(3). In such a situation, the exporter is entitled to get deduction under section 80HHC for entire sale consideration of DEPB, *i.e.*, face value and premium both.

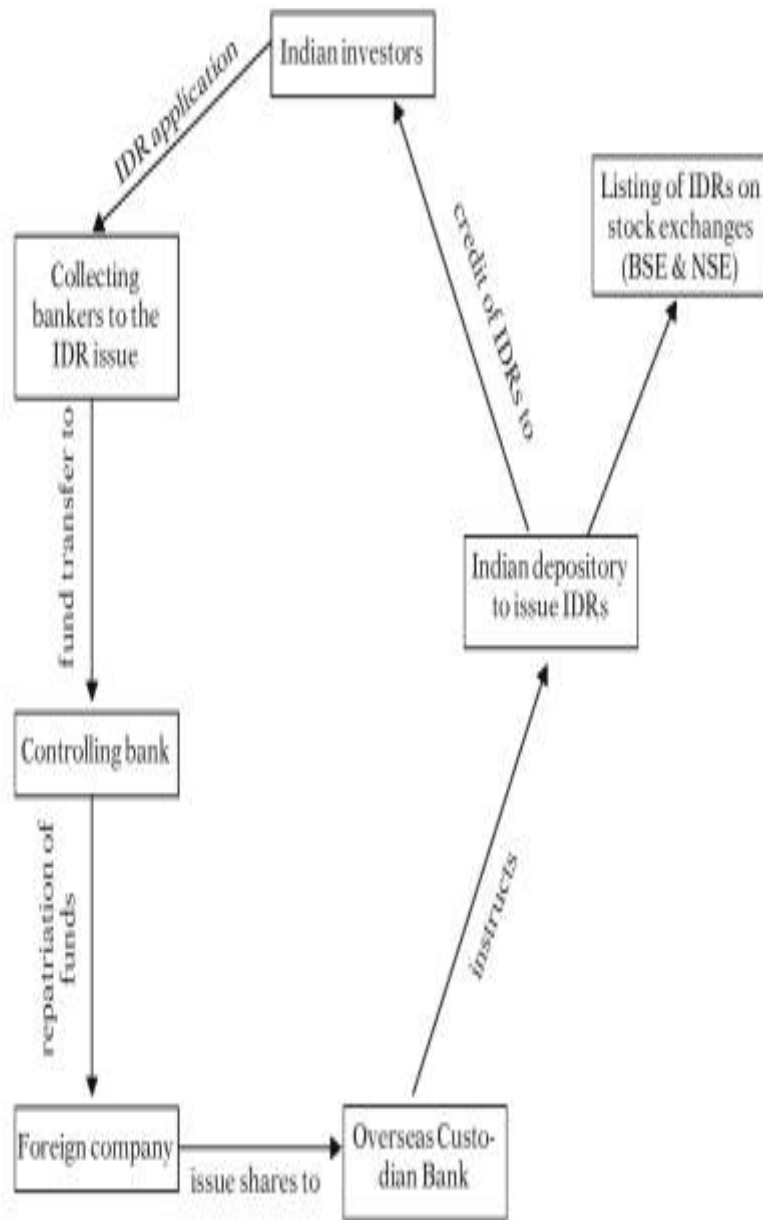
The situation mentioned at point (iv) above is covered by section 28(iii) and third proviso to section 80HHC(3). In such a situation also, the exporter is entitled to get deduction under section 80HHC for entire sale consideration of DEPB, *i.e.*, face value and premium both.

The situations mentioned at points (v) and (vi) above are covered by section 28(iii) and in accordance with the different meanings of language of section 28(iii) being interpreted, it may create different results—

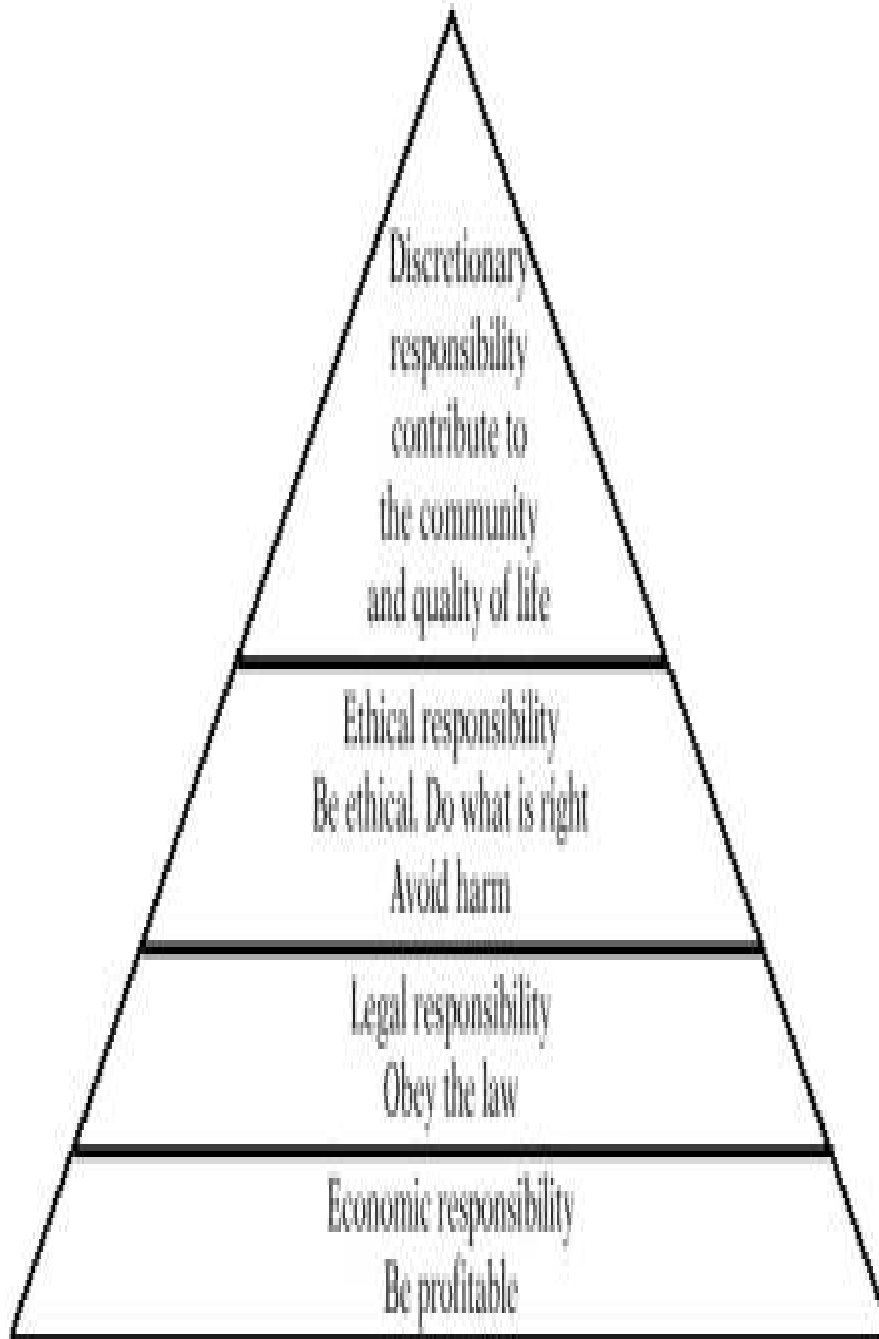
- (a) In case meaning of language of section 28(iii) is interpreted as full sale consideration of DEPB, the exporter will not be entitled to deduction under section 80HHC on the entire sale consideration, *i.e.*, neither on the face value of the DEPB instrument nor on the premium on transfer of DEPB.
- (b) In case meaning of language of section 28(iii) is interpreted as premium on transfer of DEPB, the exporter will be entitled to get deduction with respect to the face value of DEPB but he will not be entitled to get deduction with respect to the premium part, if any, in case of transfer of DEPB.

The above situations and analysis has been described by way of flow chart as under—

IN CASE (iii) MEANS—FULL SALE CONSIDERATION



IN CASE (iii) MEANS—PREMIUM ON TRANSFER OF DEPB



From the above discussion, it follows that in the first two situations the assessee is entitled to full deduction under section 80HHC for the value of export incentive which is granted by the Government and there is no issue of premium involved in these two situations. In the next two situations, as discussed above, he becomes entitled to the entire sale consideration, *i.e.*, face value of DEPB *plus* premium on transfer, if any, received. However, in the last two situations, he will not be entitled to get deduction under section 80HHC at all in case interpretation of language of section 28(iid) is taken as full sale consideration.

The denial of deduction in its entirety in the last two situations cannot be the legislative intent. When all the above six situations are at par with respect to the export incentive to be given by the Government to the exporter in the form of duty drawback or DEPB, legislative intent shall be to grant deduction under section 80HHC in all situations to the extent of face value of DEPB, *i.e.*, the benefit of export incentive granted by the Government. The denial of deduction under section 80HHC can only be for the premium part on transfer of DEPB and that too when such premium is also not in the nature of export incentive.

The legislative intent to grant deduction under section 80HHC with respect to face value of DEPB can be achieved when the language of section 28(iid) is interpreted to mean premium on transfer of DEPB. In such a case, when exporter does not comply with the conditions mentioned under third proviso, he would be disentitled to deduction under section 80HHC with respect to premium part on transfer of DEPB since such premium would be in the nature of independent income and such a result would also be in consonance with the legislative intent.

Nature of premium on transfer of DEPB ?- Whether export incentive or independent income?

9. Premium on transfer of DEPB may arise in different situations as envisaged by third proviso to section 80HHC(3), which may be as under—

- (a) When the exporter has no option to choose between duty drawback or DEPB.

(b) When the exporter has the option and while choosing the option of DEPB, rate of DEPB is higher than duty drawback.

(c) When the exporter has the option and while choosing the option of DEPB, rate of DEPB is lower than duty drawback.

In case of situation mentioned at (a) above, when the exporter has no option to choose between duty drawback and DEPB, whatever benefit of DEPB as per its face value is granted by the Government, it is in the nature of export incentive. Any premium fetched by transfer of DEPB in the open

market would be the premium created in the market due to market forces of demand and supply.

In case of situation mentioned at (b) above, when the exporter has the option to choose between duty drawback and DEPB, e.g. rate of duty drawback is, say, 10 per cent and rate of DEPB is, say, 12 per cent and the exporter chooses DEPB and gets benefit of export incentive from the Government up to 12 per cent of export, any premium further fetched by him by transfer of DEPB in the open market would be the premium created in the market due to market forces of demand and supply. Face value of DEPB having rate of 12 per cent of export in the above example, is the maximum benefit granted by the Government and this face value is in the nature of export incentive.

In case of situation mentioned at (c) above, when the exporter has the option to choose between DEPB and duty drawback e.g. rate of duty drawback is, say, 10 per cent and rate of DEPB is, say, 8 per cent and the exporter exercises the option to choose DEPB having lower rate of 8 per cent of export value, in such a case, premium is likely to be created in the market to the extent of difference of rate of duty drawback in excess of rate of DEPB, since the intended buyer will get benefit of DEPB up to the rate of duty drawback applicable. Such premium comes in the nature of export incentive. The role of market forces of demand and supply in creating premium in the market in such a situation can also be there but the dominant element of premium in such a situation would be due to higher value of benefit available to intended buyer in the market and, therefore, such premium has been treated by the Legislature as per the third proviso to be in the nature of export incentive.

Object and intent of third proviso to section 80HHC(3)

10. From the above discussion, it follows that the object of third proviso is not denial of deduction under section 80HHC on the face value of DEPB, but it is to provide deduction under section 80HHC to those who are covered within its ambit even with respect to the premium on transfer of DEPB in addition to the face value. The rationale behind it is, as discussed above, that such premium shall be dominantly in the nature of export incentive and not in the nature of independent income. It is an enabling provision and it should not be viewed as a disabling provision. Proviso to section 80HHC(3) is a provision to grant deduction in certain situations to the exporter and the legislative intent cannot be to take away the benefit of deduction by way of proviso under this section.

In other words, it can be stated that the object of third proviso is denial of deduction under section 80HHC with respect to the premium which is fetched on transfer of DEPB when such premium is created in the market

due to market forces of demand and supply since such premium in that case takes the colour and character of independent income.

In the case of exporter having turnover of less than Rs. 10 crores, as per second proviso to section 80HHC(3) deduction for the face value and the entire premium on transfer, if any, is available. The premium fetched in such a case may also contain the element of the premium created due to market forces of demand and supply but the Legislature seems to have intentionally allowed such benefit to the small exporters. The object in such a case is to grant extra incentive to the small exporters so as to promote them. Moreover, it would not only be difficult but impossible to bifurcate the nature of premium created in the two elements as discussed above.

However, from the above, it follows that the object and intent of a beneficial provision in the forms of provisos under section 80HHC(3) incorporated by the Legislature is to grant deduction and not to take away the deduction.

Nature and object of clauses (iia) to (iic) of section 28

11. Clauses (iia), (iib) and (iic) were introduced in section 28 by the Finance Act, 1990 with retrospective effect from the year in which the respective scheme of export incentive was introduced by the Central Government. These clauses were introduced in section 28 to clarify the legislative intent that the nature of such incentives is revenue receipt and not capital receipt. Such clarification was required in the backdrop of the controversy on this issue. In the case of *Gedore Tools India (P.) Ltd. v. IAC* [1988] [25 ITD 193](#) (Delhi) (SB), it was held that such export incentives are in the nature of capital receipt and, therefore, not liable to tax. Still in some other cases, it was held that import entitlements resulted into casual and non-recurring income and, hence, exempt from taxation, as observed in para 36 of the order by Special Bench in the case of *Topman Exports (supra)*. On the other hand, the Bombay High Court in the case of *Metal Rolling Works (P.) Ltd. v. CIT* [1983] [142 ITR 170](#)/[1982] [11 Taxman 209](#), held that the import entitlements were in the nature of business profits. A similar view was expressed by the Allahabad High Court in the case of *Agra Chain Mfg. Co. v. CIT* [1978] [114 ITR 840](#).

Nature and object of clauses (iid) and (iie) of section 28

12. Clauses (iid) and (iie) were introduced under section 28 by the Taxation Laws (Amendment) Act, 2005 with retrospective effect from April 1, 1998, i.e., the date since when the scheme of DEPB and DFRC were introduced as export incentive by the Central Government. The Finance

Minister at the time of moving the Taxation Laws (Amendment) Bill, 2005 in the Parliament made the following speech -

"We are now dealing with only the period 1st April, 1998 to 31st March, 2005. That is a period of about seven years. This problem did not arise before 1st April, 1998. This problem does not arise after 1st April, 2005. In this period of seven years, the relevant sections—I am not getting into an exposition of the law—are section 28 and section 80HHC. These are the two sections which are relevant. Now, the Department's interpretation is that DEPB credit sale—I will explain what

it is—not export profit. What is a DEPB credit sale ? A DEPB credit sale is, that on your DEPB passbook, if you have certain credits in your favour, you can import items against the credit without paying duty. But you can also sell the credit to another importer. If you actually import, it is part of export-import. If you sell it to another importer and make a profit on that premium, it is not export profit. It is simple business profit because the income you earn is not in foreign exchange, it is in Indian rupees. It does not arise out of export activity or import activity. It arises because you are trading in a 'License' which has a premium in the market. So, the Department took the view that it does not fall under section 28 read with section 80HHC. I am not going into the sub-sections. Therefore, this is not to be counted as exempted export profit. This must be added back as taxable profit. The assessee took a different viewIn appeal, the Tribunal has observed that the same falls under section 28(iv) if not under section 28(iiiib) or (iiic). It falls under section 28(iv). Then, the Tribunal gave a judgment, which I find as a lawyer difficult to understand. But with great respect to the Tribunal which is entitled to take a view, the Tribunal gave a judgment that although it falls under section 28(iv), it does not fall under section 80HHC 'Explanation' (baa)....."

From the above background, it follows that the object and intent of the Legislature while introducing clauses (iiid) and (iiie) was to clarify that the premium on sale of DEPB is a business profit and it is not to be counted as exempted export profit and it has to be added back as taxable profit. Therefore, along with the introduction of clauses (iiid) and (iiie) to section 28 second, third and fourth provisos were simultaneously introduced under section 80HHC(3) by the Taxation Laws (Amendment) Act, 2005 with retrospective effect from April 1, 1998.

Thus, the object and intent of introduction of clauses (iiid) and (iiie) under section 28 is to be read with the object and intent of introduction of second, third and fourth provisos under section 80HHC. The object and intent of introduction of clauses (iiid) and (iiie) under section 28 should not be read and interpreted with the object and intent of introduction of clauses (iiia) to (iiic) under section 28, which was different at that point of time as discussed earlier.

It is important to note here that the object and intent of the Legislature to incorporate clauses (iiid) and (iiie) in section 28 was not to clarify the intent

that such export incentives are also in the nature of revenue receipts as was the case while incorporating clauses (iiia) to (iiic) in section 28. It is clear from the fact that clauses (iiid) and (iiie) were incorporated in section 28 to clarify and resolve another controversy as discussed above by the Taxation Laws (Amendment) Act, 2005 with retrospective effect from April 1, 1998 and not prior to that while these export incentives were introduced by the Central Government in the year 1998. Probably, the Legislature never thought and rightly so that there can be any further controversy regarding the nature of these incentives whether that of capital or revenue when the same are in the same nature and in substitution to the export incentives as mentioned in clauses (iiia) to (iiic).

In view of the above discussion also, it is evident that the interpretation of the language under clause (iiid) has to be read as premium on the transfer of DEPB and not the full sale consideration on transfer of DEPB.

Use of the words 'any profit on the transfer' under clauses (iiid) and (iiie) is with the specific intention

13. The above argument may further be strengthened from the fact that the Legislature has intentionally used the words 'any profit on the transfer' under clauses (iiid) and (iiie) and as well as earlier under clause (iiia). It is for the reason that instruments covered under these clauses are tradable in the market and may fetch premium/profits on transfer. In case legislative intent was to cover full sale consideration on transfer of DEPB under clause (iiid), the same expression could have been used but it was not the case and the Legislature wanted to refer and cover only the premium on transfer of DEPB. Therefore, the words 'any profits on transfer' have been used and these words are required to be interpreted to mean only the premium on transfer of DEPB in view of the principle of harmonized construction of the statute.

The present controversy under debate could not arise with respect to import license referred under clause (iiia) earlier though the words used under clause (iiia) are also 'profits on sale of a license'. It is for the reason that under first proviso to section 80HHC(3) wherein corresponding deduction for export incentive has been granted, there are no conditions stipulated for allowability of deduction as is the case under third and fourth proviso. Since there are no stipulated conditions under first proviso, it does not make a difference whether meaning of clause (iiia) is interpreted to be full sale consideration or only premium part thereof since under both the interpretations, exporter would be entitled to full deduction under section 80HHC.

Why controversy has crept in the order of Special Bench of ITAT/Bombay High Court?

14. After reading the judgment of Special Bench of ITAT in the case of *Topman Exports (supra)*, it can be stated that the conclusion drawn by the ITAT that exporter would be entitled to get deduction under section 80HHC on the face value of DEPB is correct but the arguments forwarded before the Bench and the basis of reasoning drawn by the Bench for the above conclusion does not seem to be strong. It seems to be so due to the reason that whole discussion has evolved around the interpretation of the language used under clause (iiid) and it further seems that it happened so because the question framed for adjudication by the Bench was not correctly framed to bring out the actual controversy as discussed in the beginning. The question referred to before the Bench was whether the entire amount received on sale of DEPB entitlements represents profit chargeable under section 28(iiid) or the profit referred to therein requires any artificial cost to be interpolated and, therefore, the whole discussion revolved around interpretation of language of section 28(iiid).

It seems that the Special Bench of the ITAT delivered the judgment interpreting the meaning of language of section 28(iiid) as premium on transfer of DEPB with the conviction in its mind in the background that as per the legislative intent of section 80HHC, deduction under section 80HHC cannot be denied with respect to the face value of DEPB to an exporter. And in this backdrop, the Hon'ble Special Bench stated various reasonings as under :—

- (a) What is received on transfer on DEPB credit is the profit, because DEPB credit under the DEPB scheme is given at a percentage of the FOB value of the exports, so as to neutralize the incidence of customs duty on the import content of the export product.

- (b) The face value of DEPB would not be covered under section 28(iiid) because it is a credit earned by the assessee.
- (c) The face value of DEPB becomes income of the assessee on accrual basis immediately after making an application seeking DEPB credit. In such a case, when there is no transfer of DEPB but income is recognized as per accounting principle by the assessee, the face value of DEPB cannot be covered under clause (iiid).
- (d) Further, in such a case, if the face value of the DEPB credit is held to be covered under section 28(iiid), it would amount to double taxation.
- (e) It can be visualized that the Legislature is not unmindful of the distinction between 'sale consideration' and 'profit' and has used the

appropriate expression to exhibit its intendment. Referring to the language of clause (iiid) of section 28, one can observe that it refers to any profit on the transfer of DEPB. (Para 46 of judgment)

- (f) One can, therefore, hold that the word 'profit' in section 28(iiid) refers to the excess of the sale proceeds over the face value of DEPB. (Para 54 of judgment)

The dilemma before the Special Bench

15. In this judgment, the Special Bench of the ITAT also observed that the face value of DEPB cannot be reduced from the cost of purchases and has to be considered as a separate species of 'business income' but while making this observation, Hon'ble Bench was also convinced on the point that categorization of the face value of DEPB as business income has to be in the manner that it remains eligible for deduction under section 80HHC. In case such, business income, *i.e.*, face value of DEPB is held to be as normal business income covered in the normal business profits, it may be caught into the earlier controversy as it cannot be said to be income derived from export business. In case such business income, *i.e.*, face value of DEPB is held to be as 'any benefit arising from business' covered under clause (iv) of section 28, it may revive the earlier controversies which were created due to such interpretation.

It seems that caught in such dilemma the Bench found the language of clause (iiib) to be of residuary nature wherein apart from cash assistance any other scheme of the Government by whatever name called may be covered and in this backdrop it seems that the Bench held that the face value of DEPB entitlement was chargeable to tax under section 28(iiib).

Fallacy in the judgment of the Bombay High Court

16. The Bombay High Court evaluated the judgment of the ITAT on the basis of reasoning given by Special Bench as discussed above which was revolving around the interpretation of the language of clause (iiid) of section 28. When these arguments were evaluated by the Bombay High Court in the context of language used under clause (iiid) of section 28 without reading with the object and intent of section 80HHC, there were equally strong and forceful counter arguments existing. The Bombay High Court found the counter arguments to be more persuasive as per the discussion held in paras 29 to 33 of the judgment of Their Lordships and, therefore, the judgment of the Special Bench of the ITAT was found to be unsustainable and was thus reversed.

Principle of harmonized construction to be applied

17. In view of the above discussion, there is a need to apply the principle of harmonized construction of statute so as to resolve the controversy. To give effect to the object and legislative intent of the deduction under section 80HHC, the language under clause (iiid), *i.e.*, 'any profit on transfer' has to be interpreted to mean 'premium on transfer of DEPB' and the Legislature also seems to have used the language in such a sense only.

Constitutional validity in question

18. It can further be stated that in case interpretation of the language of clause (iiid) of section 28 is still held to mean 'sale consideration on transfer of DEPB', then the constitutional validity of the provision of either clause (iiid) of section 28 or third proviso to section 80HHC will come in question on several scores and either of these two provisions will be required to be read down suitably so as to give impact to the legislative object and intent of the deduction under section 80HHC.

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